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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1962

No. 447

VALLEY MORRIS PLAN, formerly The Stockton Morris Plan Company,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
to the United States Court of Appeals for the Ninth Circuit

HAROLD J. WILLIS,
511 Bank of Stockton Building,
Stockton 2, California,
Attorney for Petitioner.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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Comes now Valley Morris Plan, formerly The Stockton Morris Plan Company, by its attorney, Harold J. Willis, and respectfully petitions this Court for writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in the case of Commissioner of Internal Revenue vs. Valley Morris Plan, formerly The Stockton Morris Plan Company, Docket No. 17,016; and respectfully represents:

OPINIONS BELOW

The opinion rendered by the Tax Court of the United States in this case is reported at 33 T.C. 572. A copy of this opinion appears in the transcript of record at pages 20 through 26, and the findings of fact by the Tax Court at pages 11 through 20 of the transcript of record. The opinion of the United States Court of Appeals for the Ninth Circuit is reported at 303 F. 2d .....

JURISDICTION

The grounds upon which the jurisdiction of the Supreme Court of the United States is invoked are as follows:

a. The date of the judgment sought to be reviewed is August 10, 1962, and it was entered on that date.

b. The Order denying petition for rehearing is dated June 29, 1962.

c. It is believed that 28 U. S. C. 1958 Ed., Sec. 1254, confers upon the Supreme Court of the United States jurisdiction to review the judgment in question by writ of certiorari.

QUESTION PRESENTED

A single question is presented for review, viz.:

Whether the indebtedness of the petitioner California industrial loan company evidenced by its outstanding Term Thrift Certificates was allowable as borrowed capital in computing its excess profits credit.

under the provisions of the Excess Profits Tax Act of 1950 (64 U. S. Stat. at L., c. 1199), found in Sec. 439, I.R.C. of 1939 (26 U. S. C. 1952 Ed., Sec. 439) added by that Act, as was held by the Tax Court; or whether such indebtedness so evidenced was not so allowable by reason of its being like the liability of a bank to its depositors, as was held by the Court of Appeals.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

Sec. 104(a), 26 U. S. C., 1952 Ed., Sec. 104(a);
Sec. 436, 26 U. S. C., 1952 Ed., Sec. 436;
Sec. 437, 26 U. S. C., 1952 Ed., Sec. 437;
Sec. 439, 26 U. S. C., 1952 Ed., Sec. 439;

Internal Revenue Code of 1954:

Sec. 7482(a), 26 U. S. C., 1958 Ed., Sec. 7482(a);
Sec. 6213, 26 U. S. C., 1958 Ed., Sec. 6213;

Judicial Code, 28 U. S. C., 1958 Ed., Sec. 1254;

California Financial Code (as in effect before Jan. 1, 1959):

Sec. 102
Sec. 3390
Sec. 3391
Sec. 3392
Sec. 3394
Sec. 3395
Sec. 18000
Sec. 18003
Sec. 18050

Sec. 18401
Sec. 18402
Sec. 18403
Sec. 18405

Treasury Regulations 130 (26 CFR, part 40)
Sec. 40.439-1

These are set out in Appendix C to this petition attached hereto.

STATEMENT OF THE CASE

The facts as found by the Tax Court (R. 11-20) may be summarized as follows:

The petitioner was organized in 1917 under the provisions of the California Industrial Loan Act (c. 522, Statutes, 1917) as The Stockton Morris Plan Company. At all times the petitioner has operated under the provisions of the said Act, as amended, i.e., California Financial Code, Division 7. Its name was changed to Valley Morris Plan in 1957. It was not a state or national bank.

The business of the petitioner from which its profits are derived consists of the discounting of installment sales contracts and notes and from the making of loans. To obtain funds for carrying on that business the petitioner sold to the general public instruments in denominations of $500 and $1,000 designated as Term Thrift Certificates by which the petitioner agreed to refund the amount paid for the certificate plus interest at 4 per cent per annum if held to maturity, or at lesser rates if redeemed before the

maturity date, and at 4 per cent per annum for each six months held after maturity. The petitioner also issued interest-bearing Installment Thrift Certificates or accounts into which any amount might be paid by the purchaser at the time of purchase and later added to or withdrawn at his option. Only the petitioner's indebtedness on its Term Thrift Certificates is, however, involved in this case since the amounts of such indebtedness were large enough, if allowable for credit, to avoid any excess profits tax.

In addition to the funds obtained from the sales of its Term Thrift Certificates and Installment Thrift Certificates the petitioner used its capital and surplus and money borrowed from banks to carry on its business.

Before the petitioner could sell or issue any of either class of its Thrift Certificates it was required by the Department of Investment, Division of Corporations of the State of California to apply for permits and extensions thereof to sell the certificates in the same manner that any commercial corporation must do to obtain a permit to sell to the public an issue of bonds, debentures, or stock. It could only sell the value of certificates for which a permit was obtained within the period stated in the permit. If the time ran out, it was necessary to apply for an extension. If the amount ran out, it was necessary to apply for a new permit for a new series of certificates.

The wording of the petitioner's Term Thrift Certificates is copied in the transcript of record at pp.

15-18, but a better impression thereof may be obtained from the printed facsimile thereof in the official report at 33 T. C. 575-576.

The provisions of the Industrial Loan Law and the regulations of the Department of Investment under which the petitioner makes loans are stringent, limiting the interest rate, the term and the security. The petitioner is required to file a detailed annual report with the Division of Corporations, including a financial statement and an analysis of surplus.

In filing its income and excess profits tax returns for the three years here involved, 1951, 1952 and 1953, the petitioner used the average daily amounts of its Term Thrift Certificates outstanding and the amounts of interest paid thereon as factors in computing its excess profits tax liability, with the result that there was no excess profits tax. The petition to the Tax Court for redetermination of the tax was based on the Commissioner's determination that credits based on the amounts of Term Thrift Certificates outstanding were not allowable.

The Tax Court determined that the credits claimed on account of the outstanding Term Thrift Certificates were valid for each of the three years on the basis that the certificates represented an indebtedness incurred in good faith for the purposes of the business and that such indebtedness was evidenced by a document which met the requirements of the statute and the regulations.

The Court of Appeals reversed the Tax Court's decision on the ground that the petitioner's liability

on its Term Thrift Certificates had not been incurred in good faith for the purposes of the business but, on the contrary, reflected a depositary liability similar to that of a commercial bank on its savings and demand accounts.

BASIS FOR FEDERAL JURISDICTION

The jurisdiction of the Tax Court of the United States was invoked by petitioner pursuant to Sec. 6213 of the Internal Revenue Code of 1954, 26 U. S. C. 1958 Ed., Sec. 6213.

REASONS FOR GRANTING THE WRIT

I.

THE DECISION OF THE COURT OF APPEALS DIRECTLY CONFLICTS IN PRINCIPLE WITH DECISIONS OF COURTS OF APPEALS FOR THE SIXTH AND TENTH CIRCUITS.

This case is practically on all fours with two other cases decided by the Courts of Appeals for the Sixth and Tenth Circuits, involving the eligibility for excess profits credit of indebtedness on instruments issued by loan companies substantially the same in legal effect as either the petitioner's Term Thrift Certificates or its Installment Thrift Certificates.

The latest case, *United States v. City Loan & Savings Co.*, 287 F. 2d 612 (C. A. 6, 1961), had been decided in favor of the taxpayer in the District Court (177 F. Supp. 343), and appealed by the Government to the Court of Appeals, which affirmed the District

Court. The Solicitor General declined to approve a petition for a writ of certiorari.

The only issue in the *City Loan* case was whether or not the taxpayer corporation's indebtedness on its obligations designated as Certificates of Deposit qualified as a factor in computing the excess profits credit under Sec. 439 of the 1950 Excess Profits Tax Law (26 U. S. C. 1952 Ed., Sec. 439). The issue differs from that in the instant case only in the difference in the names and the form of the instruments evidencing the indebtedness. The facts in the *City Loan* case were, if anything, more favorable to the Government than they are in the instant case, particularly with respect to the dignity of the certificate involved. In that case, too, the counsel for the Government brought in the same argument about the indebtedness being a liability as a depositary and not one incurred in good faith for the purposes of the business, as they did in the instant case. The Court of Appeals, however, found no difficulty in unanimously affirming the judgment of the District Court.

In an earlier case, *Jackson Finance & Thrift Co. v. Commissioner*, 260 F. 2d 578 (C. A. 10, 1958), the Court reversed the decision by the Tax Court, 29 T. C. 272 (1957), which had been adverse to the taxpayer corporation. As in the *City Loan* case, the Solicitor General declined to approve a petition for a writ of certiorari.

The sole issue in the *Jackson Finance* case was whether or not its indebtedness on its Thrift Certificates (quite similar to this petitioner's Installment

Thrift Certificates) was a factor in computing its excess profits credit under the provisions of Sec. 439 of the Excess Profits Tax Law of 1950 (26 U. S. C. 1952 Ed., Sec. 439), which issue differs from that in the instant case only as to the form of the instruments evidencing the indebtedness. In that case, as in the instant one, the Commissioner advanced the same argument about the indebtedness in question being that of a depository and not one incurred in good faith for the purposes of the taxpayer's business. The Court of Appeals, however, found no difficulty in disposing of that argument and reversing the Tax Court decision unanimously.

In both the *Jackson Finance* and the *City Loan* cases the facts were more favorable to the Commissioner or the Government, respectively, than they are in the instant case. In the *Jackson Finance* case, for instance, the supervision of the taxpayer corporation as a Utah Industrial Loan company was by the State Bank Commissioner, whose principal duty was the supervision of banks and trust companies, a circumstance which brought the taxpayer corporation partly within the 1939 Internal Revenue Code's definition of a bank, Sec. 104 *idem* (26 U. S. C. 1952 Ed., Sec. 104). In the *City Loan* case, the instruments evidencing the indebtedness were called certificates of *deposit* and were in the usual form of a certificate of deposit issued *by a commercial bank* (cf. facsimile copy printed as note 5 of the Court of Appeals' report, 287 F. 2d 612); whereas this petitioner's Term Thrift Certificates were instruments comparable to a bond or debenture.

In its opinion in the instant case the Court of Appeals for the Ninth Circuit has discussed the *Jackson Finance* case (Appendix A, pages 24 through 31), but does not make any attempt to distinguish the *City Loan* case. The latter case is not even mentioned in the opinion. In discussing the *Jackson Finance* decision the Court of Appeals showed to its own satisfaction that the decision was wrong because their brethren in the Tenth Circuit misjudged the facts as to the motivation of the average purchaser of Jackson Finance Company's thrift certificates who, in the words of the opinion (Appendix A, p. 30) "would not enter into any such transaction if he did not believe the institution to be a reasonably safe place to place his funds". The reliance of the Court of Appeals for the Tenth Circuit as to the effect of Utah law on the question of the quality of the indebtedness of the petitioner industrial loan company as incurred in good faith for the purpose of the business was brushed aside by the Court below as being incompatible with Federal law to the conclusion that the *Jackson Finance* decision "is not supported by reason and has no application to the present case".

It is the petitioner's contention that both the *Jackson Finance* and *City Loan* cases were rightly decided and were precedents which the Court of Appeals for the Ninth Circuit should have followed, especially since, as has been pointed out above, the facts in the instant case are so much less favorable to the Commissioner or the Government than they were in each of those cases.

II

THE COURT OF APPEALS IMPROPERLY SET ASIDE FINDINGS OF FACT BASED ON STIPULATION OF THE PARTIES.

The exclusive jurisdiction of the Courts of Appeal to review decisions of the Tax Court is based on Sec. 7482(a), Internal Revenue Code of 1954 (26 U. S. C. 1958 Ed., Sec. 7482(a)), which Section provides that the review shall be "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury". The rules approved by this Court with respect to appeals from the District Courts were therefore binding on the Court of Appeals in the instant case.

A pertinent provision of Rule 52 of such rules is as follows: "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

In the Tax Court's findings of fact it is stated (R. 13) that "each Term Thrift Certificate represents a lump sum placed with the petitioner as an *investment*"; and (R. 19) that "the money obtained by the petitioner on the issuance of certificates *is used in its business* in making loans and purchasing paper, notes, conditional sales contracts and other evidence of indebtedness"; and that "the only other money which the petitioner had available for *business purposes* is capital and money borrowed from banks." Further on, in the Tax Court's opinion it is stated (R. 21) that "the petitioner's indebtedness on the Term Thrift

Certificates was incurred in good faith for the *purpose of the business. . . .*" (Emphases added.)

The fairly obvious basis of those findings is found in the first sentence of paragraph 4 of the stipulation of facts between the parties (R. 6) which was entered in evidence at the trial of the case (R. 35) and which reads as follows:

> "To obtain funds in addition to the petitioner's capital stock and retained earnings for the income transactions indicated in Exhibits 1-A, 2-B and 3-C [the petitioner's income tax returns] for the years involved in this proceeding, the petitioner during and before those years (a) borrowed money on bank loans, (b) sold and issued for cash certain full-paid Term Thrift Certificates, and (c) sold and issued for cash certain Installment Thrift Certificates, which two kinds of Thrift Certificates are more fully described hereunder."

Those findings were directly supplemented by the testimony of Mr. Fuld, the petitioner's president (R. 42) quoted in the Court of Appeals' opinion (Appendix A, p. 19), and indirectly by Mr. Fuld's testimony regarding the obtaining of permits from the California Corporations Commissioner to issue a series of Term Thrift Certificates (R. 40) and by Exhibits 9 to 17, inclusive, and 19. There was no evidence whatever to the contrary introduced by the respondent Commissioner.

The opinion of the Court of Appeals concludes, however, that "the respondent [petitioner here] has

failed to meet its burden of proof to establish that the money was borrowed for the purposes of the business" (Appendix A, p. 20); and, further, after its having found that the petitioner's Term Thrift Certificates qualify as "certificates of deposit" the Court of Appeals found (Appendix A, p. 20), as follows:

> "Respondent [petitioner here] must concede that a considerable part of its business was the advertising and selling to the public of thrift certificates. The money so received from thrift certificates did not constitute money borrowed for the purpose of respondent's [petitioner's] business and payments of money for which respondent [petitioner] issued its thrift certificates, either Term or Installment, were deposits."

On this record of findings of fact by the Tax Court and the Court of Appeals it is submitted that the above-quoted stipulation of the parties compelled the Tax Court to find substantially as it did as to the purpose of the petitioner in incurring indebtedness on its Term Thrift Certificates "in good faith for the purpose of its business", and that the reversal of the Tax Court's findings so based on the stipulation is clearly prohibited by the above-quoted provisions of Rule 52.

III

THE COURT OF APPEALS IMPROPERLY REVERSED THE TAX COURT ON AN ISSUE NOT RAISED BY THE PLEADINGS.

The Court of Appeals reversed the finding of the Tax Court on the basis of the Commissioner peti-

tioner's arguments on an issue, whether or not the respondent industrial loan company was to be classified as a bank for income tax purposes, which was not raised by the pleadings and not considered by the trial Court. This was improper. *Hormel v. Helvering,* 312 U. S. 552, 557, 85 L. Ed. 1037, 61 S. Ct. 719, 721 (1941).

The Court of Appeals had itself specifically approved that rule in *Harbor Plywood Corporation v. Commissioner,* 143 F. 2d 780, 783, on the authority of an earlier opinion of this Court in *Helvering v. Tex-Penn Oil Co.,* 300 U. S. 481, 498, 57 S. Ct. 569, 81 L. Ed. 755.

In the petition to the Tax Court there were seven counts of error in the computation of excess profits tax in the Commissioner's determination of tax, i.e., one positive statement of the error and one negative statement for each of the three years and one general count relating to all three years. To those assignments of error the Commissioner replied by a general denial in the following words:

> "4. A to G inclusive. Denies the allegations of error contained in subparagraphs A to G, inclusive, of paragraph 4 of the petition."

There was no further pleading as to the issues.

The resulting issue before the Tax Court was correctly stated in its opinion (R. 11, 21) as follows:

> "The only issue for decision is whether the petitioner is entitled in computing its excess profits credit under section 439(b)(1), to include in the computation of its borrowed capital the

amount of its outstanding 'Term Thrift Certificates.'"

In spite of the case having a single issue framed by the pleadings to the Tax Court, and without any attempt whatever by the Commissioner to amend his answer to raise any other issue, he has nevertheless attempted to bring in another issue, i.e., whether or not the petitioner was to be treated as a "bank" for Federal income tax purposes. Cf. assignments of error 3 and 4 of the petition for review (R. 30).

The definition in Sec. 439(b)(1) has two requirements, viz.: (1) that of the *quality*, or *purpose*, of the indebtedness indicated by the phrase "incurred in good faith for the purposes of the business", and (2) that of the form of the document evidencing the indebtedness, a list of acceptable forms being included in the definition. (See Appendix C, pp. 52-53.) As to the first requirement, the *quality*, or *purpose*, of the indebtedness, argument to either the Tax Court or to the Court of Appeals was, as we have shown in Argument II above, precluded by the stipulation of the parties in paragraph 4 of the stipulation of facts, and was moot as pertaining to a question settled by the parties even before the trial, as well as for the reason that it pertained to an issue not raised by the pleadings and not before either the trial Court or the Court of Appeals.

The greater space and emphasis in the respondent Commissioner's briefs to the Tax Court were devoted to arguments on this supposed "bank" issue. Confining its remarks to the limited issue actually raised

by the pleadings, the Tax Court, in its opinion, does not mention the arguments on the "bank" issue. Substantially the same irrelevant arguments were advanced on behalf of the Commissioner in the briefs to the Court of Appeals. That Court refused to recognize them as moot as being on an *issue not raised by the pleadings,* and, for that reason, in accord with the Court's own opinion in *Harbor Plywood Corporation v. Commissioner, supra,* not to be considered by it. On the contrary, uncritically and wholeheartedly the Court adopted the respondent Commissioner's argument on the irrelevant "bank" issue and made it the foundation of its opinion by following the completely irrelevant *Staunton* and *Morris Plan Bank* cases cited therein.

It is submitted that the Court of Appeals has erred in departing from the rule set forth by this Court in *Hormel v. Helvering, supra,* and *Helvering v. Tex-Penn Oil Co., supra.*

IV

THE COURT OF APPEALS HAS ERRONEOUSLY DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.

In overruling the Tax Court and going directly against the final decisions on the identical question by the Courts of Appeals for the Sixth and Tenth Circuits, the Court of Appeals for the Ninth Circuit has opened up a dispute concerning the excess profits tax liabilities of industrial loan or Morris Plan companies which, until that overruling decision was made,

appeared to have been settled after eight years (1954 to date) of opposition by the Internal Revenue Service. While the cases of no more than six such companies have reached trial in the Tax Court or District Courts, a very considerable number of other cases involving many thousands of dollars in tax have been held up by deferment on the Tax Court docket and by other means pending the settlement of the common issue as to credit for outstanding thrift certificates or accounts of such companies.

As noted in Argument I above, the Court of Appeals for the Ninth Circuit breached the unanimity of the Courts of Appeals and the Tax Court by the questionable process of holding that the decision of the Court of Appeals for the Tenth Circuit had been reached by misconstruing the facts of the motivation of persons buying thrift certificates, and by utterly ignoring the very pertinent opinion of the Court of Appeals for the Sixth Circuit. It then went on to reverse the findings of fact by the Tax Court by a complete disregard for rules of judicial conduct of long standing as we have shown in Arguments II and III above.

In view of the uncertainty which exists even after a long period of litigation by reason of this aberrant decision by the Court of Appeals for the Ninth Circuit, uniformity of statutory application urgently requires that a decision on the question involved in these cases be rendered by this Court. It is respectfully requested for that reason that this writ prayed for be granted.

CONCLUSION

For the reasons set forth above, this petition for a writ of certiorari should be granted.

Dated, Stockton, California,
September 12, 1962.

Respectfully submitted,

HAROLD J. WILLIS,
Attorney for Petitioner.

(Appendices A, B and C Follow)